Desmarais

ENERGY CORPORATION

1997

Annual Report

Desmarais Energy Corporation is a junior oil and gas Company which commenced full operations in June 1997. In its short history, the Company has generated cash flow from light gravity crude oil production at Pigeon Lake, and gas and natural gas liquids production at Bigoray; and has purchased undeveloped lands at Chip Lake South and Bigoray West. Its initial production purchase has enabled the Company to concentrate on developing drillable prospects in a concentrated core area, with the exploration drilling phase to commence in 1998.

Desmarais is committed to increasing shareholder value, primarily through successful exploration and development of low to medium risk multi-zone prospects in west central Alberta, complemented with strategic property acquisitions.

The Common Shares of Desmarais are listed on The Alberta Stock Exchange under the trading symbol DES.

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ANNUAL MEETING

The Annual Meeting of Shareholders of Desmarais Energy Corporation will be held on May 14, 1998 at 3:00 p.m. at the offices of Burnet, Duckworth & Palmer, located at 1400, First Canadian Centre, 350 - 7th Avenue S.W. Calgary, Alberta.

Report to Shareholders

HIGHLIGHTS

The year 1997 saw Desmarais commence full operations as a junior oil and gas company with the following significant achievements:

- Concluded a Major Transaction which provided an oil and gas reserve base, production and cash flow (see Note 2 to the Financial Statements for details)
- Completed a private placement of 750,000 Common Shares at $0.50 per share
- Acquired a 50% working interest in three sections of land with multi-zone potential in one of the Company's core areas
- Opened an office in Calgary's downtown core

The Company's first production commenced on March 1, 1997, the effective date for the purchase of certain oil and gas assets in west central Alberta, although all production, revenue and outlays to closing on June 19, 1997 were accounted for as a purchase price adjustment.

FINANCIAL

Oil and gas revenue net of royalties for the period since June 19, 1997 to year end was $103,753. The Company's share of production for the operating period was 4,160 barrels of oil and natural gas liquids or 21 BOPD, and 2,603 mcf or 36 mcf/d for the days of gas production. The Bigoray 10-15 gaswell was placed on production during August, September, and part of October 1997 but was subsequently shut-in for operational reasons. Having been re-completed in the first quarter of 1998, this well is flowing gas from the Ostracod Sands. Nominal amounts of gas were also marketed from intermittent gas conservation at Pigeon Lake. After the installation of a compressor, solution gas is scheduled for delivery from Pigeon Lake commencing in late April 1998.

Interest income for the year 1997 was $11,194 compared to $13,951 in 1996, a decrease of $2,757 which was primarily due to a lower amount of surplus funds and declining interest rates. At December 31, 1997, the Company had $276,654 of cash and short term investments. Operating expenses during the operating period in 1997 were $42,967. The relatively high operating expenses are due to a number of workovers at Pigeon Lake. The cash netback from operations was $13.75 per BOE with oil and gas sales averaging $24.34, royalties $0.87 and operating costs $9.72 per BOE.

General and administrative expenses for the year 1997 were $77,353 compared to $11,343 in 1996. The increase of $66,010 is primarily due to $16,406 outlayed for third party costs related to the evaluation and submission of bids on prospective acquisitions, $25,000 for management fees for the last five months of 1997 and $11,671 for lease rentals for the office opened on August 1, 1997. In addition, overhead was incurred in 1997 for normal corporate expenses of operating as an active oil and gas Company which were not incurred previously.

Depletion, depreciation and amortization for the operating period in 1997 was $40,897, or $9.25 per BOE. For the year ended December 31, 1997, the Company incurred a net loss of $46,270. During 1996, the Company had net earnings of $1,476.

OPERATIONS

The 1997 capital expenditures totalled $635,436 of which $436,265 was for oil and gas assets acquired as part of the Major Transaction, $131,878 for the Crown acreage acquired and $67,294 for other investments. In accordance with an independent engineering report as at January 1, 1998, the Company had proved reserves of 34.7 MSTB of oil and natural gas liquids, and 136.1 MMSCF of gas as well as probable additional reserves (risked at 50%) of 16.4 MSTB and 395.0 MMSCF respectively.

OUTLOOK

In the coming year, Desmarais intends to focus on exploration and development of its own lands, developing its own plays, and expanding its land base, while continuing to assess potential oil and gas acquisitions in its preferred core areas. In this regard, the net land holdings of Desmarais increased to 1,375 acres during the last quarter of 1997 with the purchase of 960 acres of multi-zone prospective exploration lands in the Bigoray area. Seismic data has been acquired on the new lands, and once interpretation has been completed, our first drilling location will be selected.

The recent ability of OPEC to adjust its production levels in order to stabilize oil prices suggests that a period of relatively stable prices can be expected in the near future. With a strong market for natural gas, and an increase in pipeline capacity for next winter, the Company expects steady growth in gas prices over the next two years.

ACKNOWLEDGEMENTS

The Directors wish to thank Mr. Orest Humeniuk for his contributions to Desmarais as a founding Director and as its Vice President, Finance. Mr. Humeniuk has resigned as Vice President, Finance, and will be retiring as a Director at the 1998 Annual Meeting.

We would like to extend our appreciation to all of the shareholders for their continued support and interest in the Company.

On Behalf of the Board of Directors

James G. Long

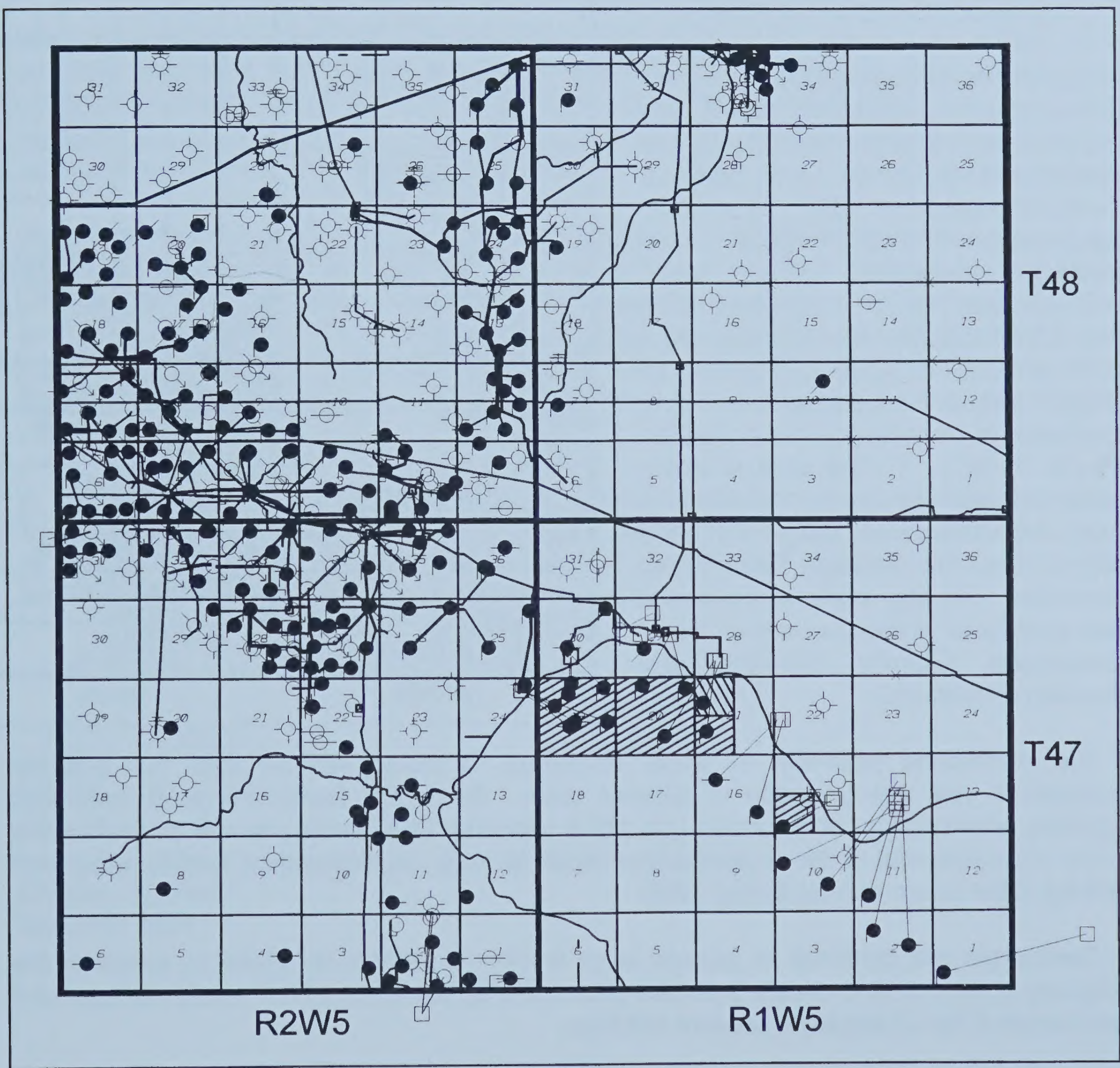
James G. Long
President
March 31,1998

Property Review

PIGEON LAKE AREA, Twp 47 – R1W5

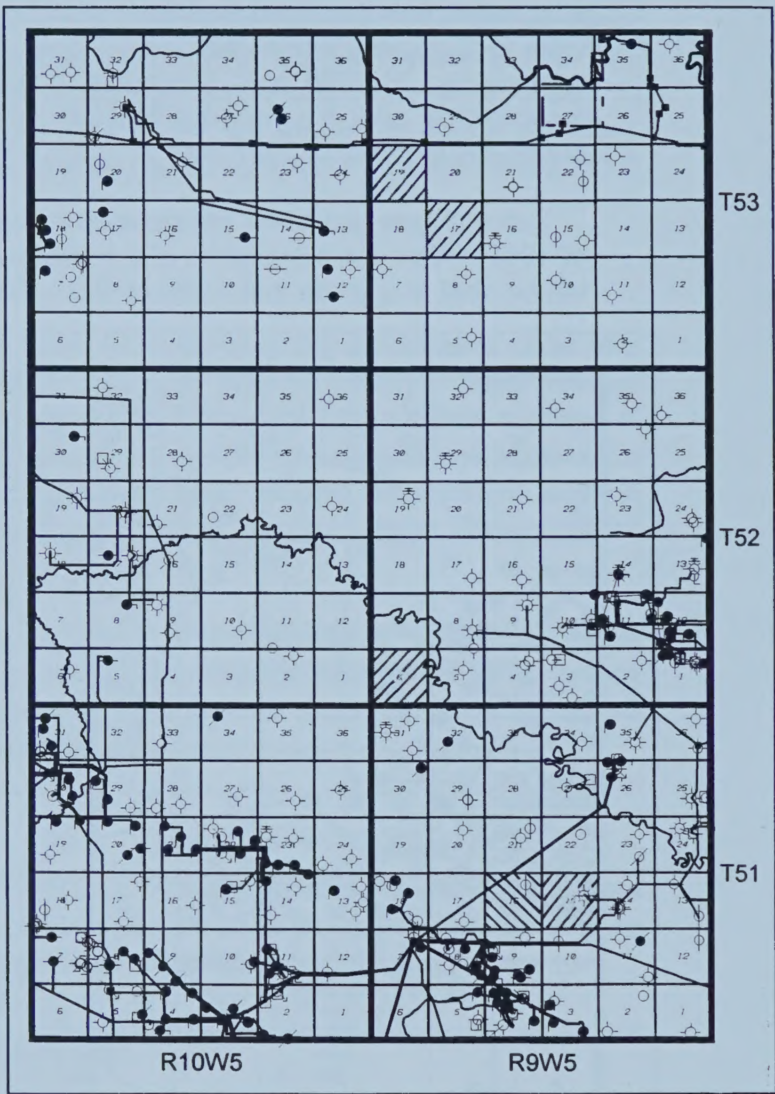
The Company's major producing property consists of varying interests (12.5% to 15.0%) in 10 producing Cardium oil wells at Pigeon Lake. The Cardium oil development was originally drilled during the early to mid 1980's with wells directionally drilled from surface locations on the shore of Pigeon Lake to Company lands underlying Pigeon Lake. A refracturing program was commenced in 1996 and completed in July 1997. All 10 wells have been recompleted and are pumping light gravity oil. Net production to Desmarais during the last half of 1997 was 21 BOPD.

Solution gas has been conserved on an intermittent basis since the spring of 1997. After the installation of a compressor in mid-April 1998, solution gas will be sold at a gross initial rate of 600 – 700 mcf/d.



BIGORAY AREA, Twp 51 – 53, R9W5

In the Bigoray Area, Desmarais owns a 10% working interest before payout (BPO), and 30% working interest after payout (APO), plus a royalty interest of 1/150 (5-15%) oil, 15% gas payable on 50% of production, in Section 15 (all P&NG). In Section 16, the Company has a BPO 17.5% working interest, and an APO 8.75% working interest (P&NG to the base Nordegg).



At the Bigoray 10-15 well, the Glauconitic zone was placed on production at approximately 400 mcf/d during August, September, and part of October 1997, but was shut in for operational reasons. This well was subsequently recompleted (February 1998) in the deeper Ostracod sands, and has been placed on production.

Bigoray is a core growth area for Desmarais. A geological project was undertaken which led to land acquisitions at Crown Land Sales in the fourth quarter of 1997. Desmarais purchased a 50% working interest in Section 6 (all P&NG), Twp 52, R9W5 in December; and in an earlier Sale in Twp 53, R9W5, Desmarais acquired a 50% working interest in Section 17 (P&NG below the base of the Viking formation to basement) and in Section 19 (all P&NG). To the west of these lands are wells currently producing oil from the Cretaceous Belly River and oil/gas from the Jurassic Rock Creek formation. Nearby wells to the south and east have tested gas in the Viking, Glauconite, Ellerslie, Nordegg, and Pekisko formations.

The multi-zone potential of these properties is being refined with the ongoing acquisition and interpretation of seismic data. Since the area has good road and pipeline accessibility, and excess gas plant capacity, Desmarais intends to realize the multi-zone potential of these prospective lands through an exploration and development drilling effort commencing during 1998.

Desmarais will continue to pursue large working interests in available lands in the Bigoray area, and to evaluate potential production acquisitions which would complement and expand the Company's present holdings.

Chartered Accountants

1200, 425 –1st Street S.W.
Calgary, Alta. T2P 3V7

(403) 267 1200
Fax: (403) 267 5950

Price Waterhouse

Auditors' Report to the Shareholders

We have audited the balance sheets of Desmarais Energy Corporation as at December 31, 1997 and 1996, the statements of earnings and retained earnings, and statements of changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996, and the results of its operations and the changes in its financial position for the years then ended, in accordance with generally accepted accounting principles.

Price Waterhouse

Chartered Accountants

Calgary, Alberta
March 6, 1998

DESMARAIS ENERGY CORPORATION

BALANCE SHEETS

As at December 31	1997	1996
Assets		
Current assets		
Cash and term deposits	$276,654	$365,928
Accounts receivable	25,773	442
Other	8,285	
Property and equipment (Note 4)	596,579	
Deferred income taxes (Note 6)	21,144	19,875
	$928,435	$386,245
Liabilities		
Current liabilities		
Accounts payable	$30,241	$ 2,165
Provision for site restoration	2,040	
Shareholders' Equity		
Share capital (Note 5)	940,948	382,604
Retained earnings (deficit)	(44,794)	1,476
	$928,435	$386,245

On behalf of the Board of Directors

James G. Long
Director

Orest Humeniuk
Director

See accompanying notes to the financial statements

DESMARAIS ENERGY CORPORATION

STATEMENTS OF EARNINGS AND RETAINED EARNINGS

Years ended December 31	1997	1996
Revenue		
Oil and gas sales	$107,594	
Royalties, net of ARTC	(3,841)	
	103,753	
Interest	11,194	$13,951
	114,947	13,951
Expenses		
Production	42,967	
General and administrative		
Management fees	25,000	
Office rent	11,671	
Property evaluation and bidding costs	16,406	
Technical database and services	5,999	4,700
Other	18,277	6,643
Depletion, depreciation and amortization	40,897	
	161,217	11,343
Net earnings (loss) before income taxes	(46,270)	2,608
Deferred income taxes (Note 6)		1,132
Net earnings (loss)	(46,270)	1,476
Retained earnings (deficit) beginning of period	1,476	
Retained earnings (deficit) end of period	$(44,794)	$1,476
Net earnings (loss) per share	**$(0.01)**	$0.00

See accompanying notes to the financial statements

DESMARAIS ENERGY CORPORATION

STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31	1997	1996
Cash provided by (used for)		
Operations		
Net earnings (loss)	$(46,270)	$ 1,476
Add charges not affecting cash		
Depletion, depreciation and amortization	40,897	
Deferred income taxes		1,132
	(5,373)	2,608
Change in non-cash working capital	(5,540)	1,723
	(10,913)	4,331
Financing		
Issue of common shares for cash	385,000	210,000
Issue of common shares for properties	175,000	
Share issue costs	(2,925)	(44,403)
	557,075	165,597
Investments		
Acquisition of property and equipment	436,265	
Additions of property and equipment	199,171	
	635,436	
Increase (decrease) in cash	(89,274)	169,928
Cash and term deposits, beginning of period	365,928	196,000
Cash and term deposits, end of period	$276,654	$365,928

See accompanying notes to the financial statements

Desmarais Energy Corporation

Notes to Financial Statements

Years ended December 31, 1997 and 1996

1. **Incorporation and Nature of Business**

The Company was incorporated under the *Business Corporations Act (Alberta)* on June 24, 1994 and its Common Shares were listed and posted for trading on The Alberta Stock Exchange on April 4, 1996 under the symbol DES. The Company is engaged in the acquisition, exploration, development and production of oil and gas reserves in Western Canada.

2. **Major Transaction**

The Company was initially classified as a Junior Capital Pool Corporation as defined by the Alberta Securities Commission. For its Major Transaction the Company concluded an agreement on June 19, 1997 with a private entity to purchase varying interests in two properties located in central Alberta west of the Fifth Meridian. The purchase price of the acquisition was paid by the issuance of 350,000 Common Shares of the Company and $275,000 cash. The Major Transaction was approved by the shareholders at the Annual and Special Meeting of Shareholders held on June 16, 1997. The effective date of the transaction was March 1, 1997.

3. **Summary of Significant Accounting Policies**

(a) Petroleum and Natural Gas Properties

The Company follows the full cost method of accounting, whereby all costs associated with the exploration for and development of oil and gas reserves are capitalized. Such costs include land acquisitions, geological and geophysical costs, carrying charges for non-producing properties, costs of drilling both productive and non-productive wells, production and gathering equipment, and administrative costs directly associated with these activities. Gains or losses are not recognized upon disposition of oil and gas properties unless crediting the proceeds against accumulated costs would result in a material change in the rate of depletion.

The capitalized costs together with estimated future capital costs associated with the development of proven reserves are depleted and depreciated using the unit-of-production method which is based on estimated proven oil and gas reserves before royalties as determined by the Company and independent engineers. The cost of significant unevaluated properties is excluded from the depletion and depreciation base. For purposes of depletion and depreciation calculations, oil and gas reserves are converted to a common unit of measure on the basis of their relative energy content or a ratio of six thousand cubic feet of gas to one barrel of oil.

The net carrying value of petroleum and natural gas properties is compared annually to the amount of the unimpaired cost of undeveloped properties plus the estimated undiscounted value of future net revenues from proven oil and natural gas reserves (based on prices and costs at year end) less estimated future general and administrative expenses, financing costs, income taxes and estimated future abandonment and site restoration costs. If this comparison indicates an excess carrying value, the excess is charged against earnings as additional depletion and depreciation.

(b) Depreciable Assets

Depreciable assets are recorded at cost and are depreciated over the useful life of the assets.

(c) Site Restoration Costs

Site restoration costs are provided for over the life of the proven reserves before royalties on a unit-of-production basis. Costs are estimated each year based upon a review of current regulations, costs, technology and industry standards. The annual charge is included in depletion and depreciation expense and site restoration expenditures are charged to the accumulated provision account as incurred.

(d) Joint Ventures

All of the exploration and production activities of the Company are conducted jointly with others and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

(e) Per Share Data

Per share amounts are calculated based on the weighted average number of shares outstanding during the year. Fully diluted per share amounts are not disclosed as the effect of the exercise of the options would not be materially dilutive.

4. **PROPERTY AND EQUIPMENT**

December 31, 1997	**Cost**	**Accumulated Depletion and Depreciation**	**Net Book Value**
Petroleum and natural gas properties	$610,033	$35,947	$574,086
Office furniture and equipment	25,403	2,910	22,493
	$635,436	$38,857	$596,579

December 31, 1996 - Nil

As at December 31, 1997, petroleum and natural gas property costs include $131,878 (1996 – nil) related to undeveloped properties which are excluded from depletion calculations until such time as the properties are evaluated.

The provision for future site restoration costs is recorded in the statement of earnings as a component of depletion, depreciation and amortization (1997 - $2,040; 1996 – nil) and on the balance sheet as a long term liability. The estimated future site restoration costs accrued to December 31, 1997 were $2,040 (1996 – nil).

No general and administrative expenses were capitalized in 1997.

5. SHARE CAPITAL

(a) Authorized

Unlimited number of Common Shares, no par value
Unlimited number of Preferred Shares, no par value

(b) Issued

The Common Shares issued are detailed below:

	Year ended December 31,			
	1997		1996	
	Number of Shares	Amount	Number of Shares	Amount
Balance at beginning of year	3,050,000	$382,604	2,000,000	$196,000
Public issue			1,000,000	200,000
Exercise of Agent's option	50,000	10,000	50,000	10,000
Private placement for cash	750,000	375,000		
Shares issued to acquire properties	350,000	175,000		
Share issue costs, less deferred taxes		(1,656)		(23,396)
	4,200,000	$940,948	3,050,000	$382,604

(c) Stock Options

The Corporation has established a stock option plan for the benefit of directors, officers, employees and consultants of the Corporation. As at December 31, 1997 and 1996, directors held options to acquire 300,000 Common Shares, exercisable at $0.20 per share until December 8, 2000. In addition, at December 31, 1997 options to acquire 100,000 Common Shares, exercisable at $0.35 per share until July 9, 2002 were also held by directors.

6. INCOME TAXES

The provision for income taxes is different from the amount computed by applying the combined Canadian Federal and Provincial tax rates to net income before income tax. The reasons for the difference are as follows:

December 31,	1997	1996
Corporate income tax rate	43.4%	43.4%
Computed expected income tax expense (recovery)	$(20,081)	$1,132
Increase (decrease) in tax resulting from:		
Non-deductible Crown payments, net	845	
Resource allowance	2,069	
Other adjustments	17,167	
Income tax	$ NIL	$1,132

As at December 31, 1997, the Company had approximately $688,815 (December 31, 1996 - $39,589) of tax pools and other deductions, including share issue costs discussed below, for deduction against future taxable income. No provision has been made for the potential recovery of income taxes in future years except for those related to share issue costs.

The cumulative share issue costs incurred to December 31, 1997 were $51,328, of which $2,608 was claimed in 1996 for deferred income tax purposes, resulting in an unclaimed amount of $48,720 as at December 31, 1997. This amount may be carried forward and used to reduce taxable income in future years. A deferred tax debit was recorded on the unclaimed amount at an income tax rate of 43.4% or $21,144.

7. Financial Instruments

The Corporation's financial instruments that are included in the balance sheet are comprised of cash, term deposits, and accounts receivable.

a) Interest rate risk
   At December 31, 1997, the increase or decrease in net earnings for each one percent change in interest rates amounts to $2,700.
b) Credit risk
   A substantial portion of the Corporation's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risk.
c) Fair values of financial assets
   The fair values of financial instruments that are included in the balance sheet approximate their carrying amount due to short-term maturity of the instruments.

8. Commitments

The Company is committed to office rental lease payments to August 2002. The minimum payments are as follows:

1998	$35,712
1999	37,109
2000	37,807
2001	39,204
2002	26,136

9. Related Party Transactions

Management fees for the services of the Company's President were $25,000 for the year ended December 31, 1997 (December 31, 1996 – NIL) and were paid to a company controlled by him.

During 1997, the Company also purchased office furniture and equipment from a company controlled by the President for an amount of $12,050, which is believed to represent fair market value of the items purchased.

Corporate Information

Directors & Officers

James G. Long
Director and President
Calgary, Alberta

Orest Humeniuk
Director
Calgary, Alberta

David F. Potter
Director
Calgary, Alberta

James G. Feeney
Director
Calgary, Alberta

Corporate Office

Suite 1510, 777 – 8th Ave. S.W.
Calgary, Alberta T2P 3R5

Telephone: (403) 234-7076
Facsimile: (403) 264-7076

Auditors

Price Waterhouse

Bankers

Toronto-Dominion Bank

Solicitors

Burnet, Duckworth & Palmer

Transfer Agent

Montreal Trust Company of Canada

Stock Exchange Listing

The Alberta Stock Exchange
Trading Symbol "DES"

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